



Minutes of the MTC Executive Committee Meeting
Washington Court Hotel—Washington, DC
11:00 AM to 5:00 PM—November 11, 2004
8:00 AM to 12:00 NOON—November 12, 2004

I. Welcome and Introductions

Chair Bruce Johnson welcomed everyone. The following were in attendance:

Name	State or Affiliation	Name	State or Affiliation
Bruce Johnson, Comm'n Chair	UT	Rich Schrader	NJ
Joe Thomas 11/11	CT	Lennie Collins	NC
Lynn Chenoweth	ID	Rick Clayburgh	ND
Ted Spangler	ID	Fred Nicely	OH
Joan Wagnon	KS	Elizabeth Harchenko	OR
Dale Vettel	MI	Bruce Christensen	SD
Jack Mansun	MN	Adina Christian	TX
Carol Fischer	MO	Will Rice	WA
Don Hoffman	MT	Scott Peterson (PM)	Streamlined
		Quentin Wilson	MO
		Emily Dagostino	State Tax Notes
MTC Staff and Consultants			
Dan Bucks	Les Koenig	Bill Six	Len Lucchi
Tom Shimkin	Frank Katz	Sheldon Laskin	Jim Rosapepe
Ken Beier	Shirley Sicilian	Roxanne Bland	
René Blocker	Elliot Dubin		

II. Public Comment Period

No public comment was offered.

III. Minutes of Executive Committee Meeting of July 28, 2004

Elizabeth Harchenko moved and Will Rice seconded approval of the minutes as filed.
Approval was unanimous.

IV. Treasurer's Report

*For more information about this meeting, please contact René Blocker, Deputy Director, Multistate Tax Commission, 444 North Capitol Street, N.W., Suite 425, Washington, D.C. 20001
Telephone (202) 624-8699 Facsimile (202) 624-8819 Email rblocker@mtc.gov*

Public Notice and Agenda
MTC Executive Committee Meeting
Washington, DC—November 11-12, 2004
Page 2

Rick Clayburgh (ND) gave the Treasurer's Report. Mr. Clayburgh noted a total current unappropriated fund balance of \$3,258,239, and a current restricted fund balance of \$578,464. Expenditures for the three-month period ended September 30, 2004 are running less than the budgeted amounts in all programs with the exception of the training program which incurred up-front development costs early in the budget year for the new Legal Training course. Contract Services shows a net favorable variance reflecting lower than budgeted expenditures in the Enterprise Automation Project department offset with higher than budgeted contract services in the Training Program. The income statement shows a favorable variance on Audit Reimbursements of \$16,000 because \$16,000 was budgeted for Nexus audits and no fees have been invoiced to the National Nexus Program yet. An unfavorable variance in Interest Income is a result of interest rates remaining lower than anticipated. Member Assessments also shows an unfavorable variance, \$37,160, due to a reduction of one state's fee that occurred after the budget was approved in July. On the Expenditure side, Salaries and Retirement shows a favorable variance from the budgeted amounts, primarily as a result of two vacant positions.

The Executive Director noted that on net, the organization did not experience a measurable increase in health insurance premiums. We have three different categories of service and there has been some shifting between categories. We budgeted for a 12.5% premium increase, but the actual increase has not been that high.

North Dakota moved for approval of the Treasurer's Report. Oregon seconded. The motion passed unanimously.

V. Chair's Report

The Chair reported on two personnel changes. Tino Barraza has resigned from Nexus Committee because of his reassignments to new duties within the Texas Comptroller's Office. His vacancy will have to be filled. Jennifer Hays resigned from Kentucky Department of Revenue and the Uniformity Committee. Wood Miller (MO) has been appointed as chair of the Income and Franchise Tax Subcommittee in her stead.

VI. Executive Director's Report

Dan Bucks announced several personnel changes: Bill Speckman (CO) has retired and will be remembered as a particularly nice and dedicated person with impressive intellect who was generous with his time. He organized one of the federalism at risk panels and was a mainstay of the industry deregulation project.

Len Lucchi has replaced Ellen Marshall with Patuxent Consulting as the Commission's D.C. lobbyist. He was County Attorney for Prince Edwards County and a former lobbyist for NACO.

Mr. Bucks noted changes in the MTC audit staff. James Kinsella and John Caporale have left. Nichole Phillips and Michael Bontrager start Monday, both in the Chicago office.

Public Notice and Agenda
MTC Executive Committee Meeting
Washington, DC—November 11-12, 2004
Page 3

NY and VT have become associate members of the Commission. VT is also joining the National Nexus Program in December. Only four states have no relationship with the Commission at this point. 47 states (including DC) are involved with the Commission in some fashion and 42 contribute to the budget of the Commission.

One state is discussing adjusting membership status that would result in reduction of fees for this year roughly in the amount of \$37,000.

Problems of noncompliance with tax laws are growing rapidly in interesting and diverse ways. The largest companies are shifting income to international tax havens. Middle sized taxpayers are using separate entities and single member LLCs in combination with the protection of P.L. 86-272 to shelter income and now also to reduce sales tax liabilities by using affiliates to purchase goods at market price for resale and then reselling the goods to a related entity at deep discount so the sales tax liability is vastly reduced. Even individual taxpayers are using residence changes to reduce capital gains reporting and using LLCs to dodge sales and use tax liability on big ticket items purchased in non-sales-tax states (such as RVs in Montana).

Federal activity will potentially affect state taxation. Congress will likely act on the Internet legislation during lame-duck session. We expect the version of S 150 that passed the Senate will be added to omnibus appropriation bill, but it is possible that nothing will happen. There has been some action on VoIP. VoIP was removed from the expansion of some telecommunications services preempted from state taxation under S 150 as it passed the Senate. The FCC this week announced an order barring state regulation of VoIP but not directly or explicitly barring state taxation. The order has not been released as yet so we don't know exact wording. Next year the telecommunications act will come up for rewriting. Last time the states were successful in getting a tax saving provision inserted that provided that the FCC has no authority over state taxes. The MTC position has been that Congress cannot delegate to FCC authority to preempt state taxing authority. Congress must do it and it must be clear and specific. The Commission will want to see the tax saving provision from the previous act renewed. The President has announced that he will pursue fundamental tax reform, possibly toward some form of consumption taxation, but how far and how fast moves toward such reform will proceed is not clear. When similar reform suggestions came up in the mid 90s, the Commission published articles explaining what the impact might be. Almost all the forms of federal reform narrow the options for the states, often by eliminating reporting systems upon which the states have relied. States may face due process problems in continuing to require the same level of reporting. The Commission has not taken a position on the forms of taxation being considered, but Mr. Bucks noted that we must be mindful of the impacts on state and local governments and be prepared to educate Congress on those impacts.

With regard to the State Tax Compliance Initiative, the Uniformity Committee has approved the model uniform Combined Reporting and Affiliate Nexus statutes, and two drafting groups are working on an expense disallowance statute and an abusive tax shelter/listed transactions statute. The Sales and Use Tax Task Force has drafted a template of a letter for distribution to tax practitioners on the availability of the voluntary

Public Notice and Agenda
MTC Executive Committee Meeting
Washington, DC—November 11-12, 2004
Page 4

disclosure program and is preparing another one that focuses on use tax compliance requirements. An information sharing task force is being formed, chaired by Will Rice (WA) and Andy Eristoff (NY). They need an additional 4-6 top Tax Administrators to join and the assignment of professional staff from agencies to help staff the task force. We still need volunteers from the standing committees to staff the pass-through entity education and training task force. René Blocker has completed a first draft of an Issues Paper on revisions to UDITPA.

There remains a controversy over whether the MTC should be selected to operate the centralized registration system required by the Streamlined Sales and Use Tax Agreement.

The Commission has filed an amicus curiae brief in the New Jersey Appellate Court in the *Lanco* case and has received three more requests for amicus support.

There were four excellent conferences recently. A statistical sampling session in Texas in October was very well received. A California FTB symposium on tax sheltering in August did a superb job in laying out current trends in this area. The MTC presented a training program on corporate income tax accompanied by an attorney boot camp in Colorado in September. Finally, there was a very well attended nexus course in Cleveland OH in October.

On the technology front, we are trying to build content on the MTC portal. We are ready with passwords for Executive Committee members, but first want to ensure that there will be content on the website that will be useful to the members so that usage will be encouraged.

The Nexus Program is doing extremely well with many voluntary disclosures.

The Audit Program has again issued a subpoena to secure information on a nexus audit. The productivity graph in the binder shows improving efficiency

VII. Strategic Planning Process

A. Report from Strategic Planning Session

Quentin Wilson gave a brief oral report on the strategic planning session. He will be getting a written report to Committee members in a few weeks. The session prioritized outcomes and goals which will be detailed in the report.

B. Next Steps

The Committee will need to devote time and effort to follow up and develop strategies on how to achieve the goals identified in the process, including improving current activities. The most important step is to create an action plan to specify who is going to do what by when.

Public Notice and Agenda
MTC Executive Committee Meeting
Washington, DC—November 11-12, 2004
Page 5

Elizabeth Harchenko reminded Commission members that we cannot expect the MTC staff to do all the work. We are a working Commission and we accomplish our results by pooling our resources, making in-kind contributions with staff and TA's own time. States will need to continue to make those kinds of contributions.

Dan Bucks thanked everyone for their active participation in the strategic planning process, and Quentin Wilson and Bill Bott for their leadership. Mr. Wilson will generate a report and staff will look at it, but the most important thing will be how states chose to take us to the next level. Do we want to take some time in California at the January Executive Committee meeting to do further strategic planning work? Ms. Harchenko suggested that after Mr. Wilson does the report we should schedule a teleconference in December to focus on what issues will be taken up at the in-person meeting in January. She volunteered to superintend the effort to get a conversation going on the plan. Mr. Bucks suggested that we put the Report on the MTC Portal and use that content to inaugurate its usage. The Chair added his thanks to Mssrs. Wilson and Bott and for the participation of all the members.

VIII. Liaison Meeting with Representatives of Tax Executives Institute

Janet Wilson thanked the Commission for the opportunity for this joint meeting, the first one in 8 years. Greg Mattson was happy to have the opportunity to revivify the relationship. Dan Bucks thanked the delegation for coming and expressed the highest regard for the TEI staff and the extent of their knowledge. He thanked them for the opportunity to have Les Koenig address TEI on the HP audit.

Ms. Wilson praised the result in the HP audit. Unfortunately, there are other audits where the feedback is not so positive. One of the concerns is the lack of up front planning for the audits. Is there an audit planning format that the auditors have when they walk in that they could share with the taxpayers?

Les Koenig responded by first noting how good it was to sit down with the taxpayer and work out a plan. Generally we start an audit with a time schedule, but frequently we are not aware of what issues might come up, so we are unable to present a fully-worked-out plan right at the start. One thing we have noticed with the increased number of states in the audits is that it is hard for an auditor to do three audits at a time; we may cut back to two audits at a time. That may help.

Ms. Wilson thinks that MTC auditors could profitably sit down with the taxpayer after a week's preliminary work to develop an audit plan.

Les Koenig noted that an occasional problem is getting the consolidated federal form 1120 up front which can make it hard for the auditor to focus on the issues.

Rick Clayburgh noted that he generally doesn't get involved in an audit unless problems surface. ND uses the MTC because it lacks sufficient auditors to do everything. His

Public Notice and Agenda
MTC Executive Committee Meeting
Washington, DC—November 11-12, 2004
Page 6

presumption is that participating in joint audits with the MTC makes it easier for the taxpayer than if it faced several separate state audits.

Ms. Wilson responded that it does make it easier. But when she schedules individual state audits she can stagger the workload, usually letting in only one state at a time. But when the MTC does an audit for several states all at once it can be difficult. It is better than 10 separate state audits, but it is more than a single state audit. Moreover, the taxpayer has no assurance that the audit will be accepted by the state. A state could have to start over. Finally, the taxpayer can face simultaneous deadlines to protest the assessments from an MTC audit for many states which puts greater pressure on the taxpayer than if separate audits were staggered.

Greg Matson noted the efficiency of the HP audit, which would be great if it could be replicated. But part of the concern is that the efficiencies can be lost if the states decided to re-audit after the MTC finishes the audit. If the audit process could be demystified, that would be helpful. Successes with the joint audit planning process have been particularly noteworthy at the federal LMSB level. In the HP audit, the Commission secured agreement from the states that they would hold themselves to the audit. That was an important part of the success of the audit.

Bruce Johnson hoped that TEI would come up with specific recommendations and work with representatives of the audit committee and Les Koenig to resolve the issues.

Dan Bucks offered this summary: TEI wants more up-front communication on audit plans. The MTC audit program is making more time for the auditors but needs some early information up front to know issues and do proper planning. We need further information on whether there is a problem with states accepting audits and assessing the taxpayer all at the same time. Taxpayers could explore the dormant multistate dispute resolution process as a way of working through some of the protest time pressures.

Ms. Wilson's next topic concerned withholding on employees who go infrequently into a state. Could the MTC create a policy for *de minimis* number of days before withholding is required? Elizabeth Harchenko noted that Oregon was able to work out withholding requirements based on how the Oregon personal income tax is structured, recognizing that the minimum bracket amount under their statute sets a *de minimis* level of earnings before a withholding requirement is triggered. The employer can then figure out the length of time that an employee can be in the state before withholding must be reported. The FTA has a uniform rule in effect for high-income type folks coming into a state for a short period. Dan Bucks noted that the Compact does permit the Commission to address multistate personal income tax issues. Bruce Johnson suggested that TEI might be on the lookout for a state that handles this issue particularly well and that may be willing to spearhead a uniformity rule. Elizabeth Harchenko pointed out, however, that any *de minimis* standard likely depends on each state's minimum bracket amount. Bruce Johnson suggested that if TEI would come with tax administrators to the legislature, they could be successful in this kind of simplification that wouldn't cost the states much in revenue.

Public Notice and Agenda
MTC Executive Committee Meeting
Washington, DC—November 11-12, 2004
Page 7

Mr. Bucks noted that TEI could request a uniformity project. The more developed the proposal the more likely the MTC could take it up.

Ms. Wilson next brought up need to uniformly extend to 90 days the due date to report RARs. Ted Spangler pointed out that the MTC has already promulgated such a uniformity proposal that sets the standard time limit for RARs at 180 days. That project derived from a list of state tax administrative simplification suggestions that the AICPA had published which didn't particularly implicate tax policy or revenues. The MTC had selected the RAR complaint as an easy one to start with. Since MTC's adoption of the uniform proposal, however, there has not been much effort to get the MTC RAR proposal enacted in the states.

Finally, Ms. Wilson asked about some of our current projects. Are there items that TEI could give input on? Bruce Johnson noted that MTC uniformity recommendations go through a public hearing process through which we do receive comments and that these comments have been invariably helpful, greatly strengthening the projects. He explained that we would like to get more such comments and requested that TEI help by distributing notice of the hearings to the relevant members and committees.

Dan Bucks noted that the Commission is developing a broad centralized, one-stop registration system for taxpayers who are required to register in states. We are going to be entering a testing phase for sales and use tax registration. The next step is to add alcohol and tobacco taxes, and then withholding taxes in Version 1.5. Sheldon Laskin stated that we are looking for volunteers to test Version 1.5 in mid 2005.

Bruce Johnson noted that the Combined Reporting and Affiliate Nexus uniformity proposals are on the agenda for approval and would go to the hearing process next; that we are working on a listed transaction type statute, on an educational data base and training program for pass through entities along with a joint information sharing data base on pass-through ownership and income flow. He asked whether there might be some sort of a permanent liaison between MTC and TEI, which would dovetail nicely with two suggested goals from our strategic planning session to reduce burdens on taxpayers and improve communications with stakeholders.

IX. Committee Reports

A. Uniformity Committee

1. Committee Report –

Ted Spangler began the report by expressing appreciation to MO and TX for allowing Wood Miller and Adina Christian serving as Chairs of the subcommittees.

The Combined Reporting Proposal has been recommended for public hearing by the Uniformity Committee. Yeoman's work from Shirley Sicilian and Mike Brownell has brought this proposal forward in less than a year. The Income and Franchise Tax

Public Notice and Agenda
MTC Executive Committee Meeting
Washington, DC—November 11-12, 2004
Page 8

Subcommittee will continue to work on two related proposals: supporting administrative rules and regulations and a review of the Joyce/Finnigan issue. Mike Brownell will prepare an issue document for the Joyce/Finnigan issue.

Work on the proposal for a special sales factor apportionment formula for telecommunications continued with a very helpful information session from Deborah Bierbaum of AT&T and Doug Hurst of Qwest. Work on the pass-through entity apportionment project is dormant because the apportionment issues are being discussed and incorporated into the Combined Reporting statute. Two small drafting groups are working on tax avoidance transactions and expense disallowance statutes. They hope to have drafts by the meeting in Tampa in March 2005.

In the sales and use tax area, the affiliate nexus proposal has been sent forward to the Executive Committee. The hotel resellers project, now the hotel intermediaries project, was advanced by a lengthy teleconference with representatives from the industry during which we discovered that they have a considerably different view of what state laws are and how their transactions fit into state law than most of the members of the committee understand to be the case. These divergent views may make the project more difficult. There is no estimate on when the committee will be able to come up with something.

The Uniformity Committee asked the income and franchise tax subcommittee to look into the sales factor apportionment regulation dealing with sales other than sales of tangible personal property and the definition employee for the payroll factor when income producing activity is done by someone other than an employee of the taxpayer.

2. Referrals to Public Hearing

a. Model Combined Reporting Statute

Don Hoffman (MT) moved and Elizabeth Harchenko seconded the referral of the combined reporting proposal to a public hearing. The motion passed unanimously.

b. Model Affiliate Nexus Statute

Bruce Christensen moved and Dale Vettel (MI) seconded the referral of the affiliate nexus proposal to a public hearing. The motion passed unanimously.

3. Other Items

Joan Wagnon asked how the Commission notifies the public about public hearings. René Blocker explained that the MTC has a mailing list of approximately 900 names, including major tax organizations, lawyers, accountants, press, BNA, Tax Notes, RIA, university and law professors, economists and other tax professionals who have requested to be informed of hearings. Also, state personnel are on the list. They are all notified by regular mail. In addition, the notice is posted on the MTC website. 30 days notice is

Public Notice and Agenda
MTC Executive Committee Meeting
Washington, DC—November 11-12, 2004
Page 9

given. Bruce Johnson suggested that the Commission might develop a ListServ for notification of public hearings if the recipients agree to notification in that manner.

B. Combined Registration Committee

Sheldon Laskin gave the report. A written report from the committee is in the binders. The committee meets every other Thursday telephonically, and a smaller group meets every Thursday. Staff has locked down the data elements for the first version of the system, but is still getting proposed data elements for Version 1.5. The committee has initiated a change control process. Naresh Verma and his staff have begun to write code for the system. The committee periodically reviews screens to make sure the code gets everything on the screen. The system will be tested with a few states to see how it works.

C. Audit Committee

Les Koenig referred to the report in the binders with its lengthy discussion on 4 income and 2 sales audits which will be discussed in closed session. He raised the issue of getting waivers from taxpayers. Particularly problematic is the statute of limitations for sales tax which expires on a monthly basis. The two options appear to be either to issue a provisional assessment or to add on months at the end of the audit period. Mr. Koenig will survey the states on provisional assessments and whether, in lieu thereof, states will be willing to add on months at end of the audit cycle. Lee Evans from NJ will be the audit committee representative on the ad hoc committee for pass-through entity educational resources and training.

Elizabeth Harchenko asked for feedback from the Audit Committee on how we might maintain communication with TEI.

D. Nexus Committee

Joe Thomas gave the report. Staff reports that an increase in requests for voluntary disclosures is putting a strain on staff time. The Committee is looking for suggestions for improvements. With regard to the lead-set program, the sixth lead-set is finished and the seventh has been started. The recent nexus training class had markedly improved attendance. The State Tax Compliance Initiative sales and use tax task force had referred three items to the committee. The use tax template, drafted by the tax task force, was reviewed and suggestions were made; there will be some revisions by the task force and the template will be resubmitted to committee. The second item was to increase publicity for the voluntary disclosure program. TX gave a presentation to the Nexus Committee on how they use the brochure and to whom they send it and do not send it. The third item was an assignment to the pass-through entity ad hoc committee. As yet no one has volunteered. Additionally, Tino Barraza, who had been serving as vice chair, has resigned from the committee so the committee is looking for a volunteer willing to serve as vice chair.

Public Notice and Agenda
MTC Executive Committee Meeting
Washington, DC—November 11-12, 2004
Page 10

Dan Bucks stated with regard to publicizing the voluntary disclosure program that the Executive Committee made a pledge to look for resources in agencies outside tax agency compliance personnel to help with this, like public information officers, and that we would also utilize the media resources the Commission uses.

Closed Session on the Audit Program, the Nexus Program and Personnel Matters

X. State Tax Compliance Initiative

A. Items Referred to Committees and Task Forces

Dan Bucks reviewed the status of the recommendations as listed on the distributed status chart. The information sharing item should reflect that the task force is in formation. Will Rice and Andrew Eristoff are the chairs and are looking for 4-6 additional TAs for the Task Force as well as participation from state agency professional staff. Elizabeth Harchenko volunteered to be on the Task Force. Recommendations CS 5 and 6 are being worked on together.

The pass-through entity education and training task force is in the process of being formed with one person from each standing committee. The audit committee recruited Lee Evans of NJ. The uniformity committee and nexus committee are looking for volunteers.

The STCI sales and use tax task force has developed a template for a letter to tax practitioners about the voluntary disclosure program, which was referred to the nexus committee. Further work is being done on the template. A second template for states that want to emphasize a use tax message is in the works. That template will go out to the states when the task force has it perfected.

Voluntary disclosure awareness has been discussed by the nexus committee along with the needed help from public information officers of the states.

The Sales and Use Tax Work Group recommendation on affiliate nexus model legislation has been acted upon. A model statute was drafted and was referred to public hearing

B. Recommendations Retained by the Executive Committee

1. Overhaul of UDITPA—Draft Issues Paper

René Blocker has distributed a draft Issues Paper on the overhaul of UDITPA. Ted Spangler asked whether part of our thinking was to involve NCCUSL. Ms. Blocker noted that she had raised that issue in her Issues Paper. Dan Bucks pointed out the potential difference from most NCCUSL projects in that UDITPA got incorporated into a state compact of which we are the administrators. Ms. Blocker noted that some issues have been dealt with by the MTC in uniformity projects, such as the business/nonbusiness and

Public Notice and Agenda
MTC Executive Committee Meeting
Washington, DC—November 11-12, 2004
Page 11

unitary business regulations. Any overhaul of UDITPA would require going to the state legislatures, a formidable political obstacle. It may be hard to move MTC regulatory changes into statute. Other major issues are the cost of performance standard for sales other than tangible personal property, overweighting of the sales factor and the short-term investment of working capital. Some of the less prominent issues derive from emerging business operations that have given rise to problems in applying UDITPA, to wit:

- contractors in the payroll factor,
- treatment of intangible property
- treatment of outer jurisdictional property
- use of appreciated basis for property factor
- exclusion of financial services and public utilities
- consideration of a throw out rule rather than a throwback rule.

Professor McLure has suggested that if UDITPA is overhauled, it should be expanded to include dealing with nexus issues as well as defining a unitary business. The MTC has dealt with both of these issues in regulation with the unitary business project and the factor presence nexus standard. Should these be part of a new UDITPA?

Political issues abound. What are the prospects for working toward consensus with the business community? Any overhaul would be impossible without it. NCCUSL involvement is also at issue. Would this lead to success? Is their process excessively long? It would take a minimum of 2 years. Can the MTC work with NCCUSL to perhaps shorten the process? Are legislatures open to looking at a revision of the model act? Is the pressure from federal bills an incentive to get states to look to revision? Can a process be put in place to ensure that the states retain uniformity over the years in a manner similar to the SSTP?

The Chair asked what should happen next. René Blocker suggested a couple of options. One would be to flesh out what revised provisions would look like. We have some pieces in place from our uniformity efforts. The other route would be to discuss first what the way to proceed is, dealing with the bigger question of process and political issues.

Elizabeth Harchenko raised two other questions. First, whether the uniform act should be replaced rather than amended and what process options are available for replacement. Second, what is the relationship of the Multistate Tax Compact to UDITPA. Many states have enacted UDIPTA in two places, both in the Compact and as a separate act. Some states have modified the UDITPA but not changed the Compact version. What are the implications that come from that? If there is a rewrite, do we have to amend the Compact also?

Dan Bucks responded that once the Uniform Act was put in the Compact, it has a life in the compact that is separate from the uniform act. And even states that haven't adopted the act have enacted similar apportionment formulae. Part of the complication is that we need to talk with NCCUSL. The biggest question, however, is whether there is support among the business community to bring the law up to date and whether there would be

Public Notice and Agenda
MTC Executive Committee Meeting
Washington, DC—November 11-12, 2004
Page 12

any agreement between the business community and the states as to what needs to be brought up to date. At the Georgetown planning meeting recently, business expressed interest in updating some of the apportionment issues. A year and a half ago in New Orleans, however, Doug Lindholm suggested that wide scale reform was not propitious at that time. We need feedback on these issues from the larger public.

Ted Spangler asked how the question of revising UDIPTA plays with the issue of major federal tax reform?

Bruce Johnson commented that a number of the issues in the UDITPA issues paper are more urgent than others and we shouldn't delay getting to work on some of the issues. He urged everyone to read the paper and share their reactions with Ms. Blocker. In January, she could come back with Version 2.0 incorporating those discussions.

Elizabeth Harchenko commented that since we are expecting some movement in Congress about restructuring federal tax anyway, there would definitely be value in developing the process of where we go with business taxes in the future. We could align our process with change if change happens, and if not, then focus on where the corporate income tax is going in the future. She harkened back to the federalism at risk process, with meetings around the country, invited experts from many areas and participation from states and local governments. The process could lay the foundation for moving in either direction. The Chair agreed that model makes a lot of sense. Dan Bucks added that it dovetails with the strategic planning goal of working with all stakeholders. It would create a significant demand on resources noted Bruce Johnson. At the January meeting, with the results of the strategic planning the Committee can perhaps evaluate such an effort in light of its other priorities.

2. Deferred Items:

- a. Publicizing MTC Uniformity Proposal on Pass-through Entity Reporting. Dan Bucks expects to present proposals in January.
- b. Formation of a Pass-through Entity Liaison Group with the IRS. Elizabeth Harchenko has volunteered for this group. Additional volunteers are needed.

XI. Streamlined Sales Tax Agreement

A. Report on Issues Under Consideration and Progress on Implementation

Mr. Bucks reviewed the progress of the project. The conforming states organization met for the first time this summer, chaired by Loren Chumley and Richard Finan of Ohio. Membership is comprised of states that are likely candidates for the Governing Board. One of the first actions was to put into effect a process for selecting an interim director and to appoint Scott Peterson in that role. Joan Wagnon is working on by-laws and Bruce Johnson on operating rules. The group is also working through a timeline for getting the

Public Notice and Agenda
MTC Executive Committee Meeting
Washington, DC—November 11-12, 2004
Page 13

agreement up and running. They expect to meet on July 1, 2005 to activate the agreement and have it go into effect on Oct. 1, 2005. They are also putting forward a process for states to practice their presentations on compliance as well as a process and deadlines for states formally to present their applications. The drop dead date for being considered at the July meeting is May 1st. Scott Peterson reported that there will also be evaluation of Certified Service Providers. Last week an RFP went out for CSPs and approximately 10 have expressed interest.

The formation of advisory councils is proceeding. Local government organizations want representation on the state and local council. The business advisory counsel is to be created by the Governing Board, but certain businesses have expressed a reluctance to be part of a government entity or to be subject to open meeting rules.

The project itself is still working on a number of issues listed in the report in the binder such as buy-downs, the taxability matrix, bundling, preview run through of compliance. There are meetings next week in Chicago of both the project and the conforming states.

B. Streamlined Combined Registration System

**1. Memorandum of Understanding between Streamlined Conforming States
and MTC on Development and issues of Operation of the System**

The report incorrectly suggests that the entire business community objected to MTC's operating the system. It was just COST.

Mr. Bucks reviewed the history. In the early 1990s with the beginning of the national nexus program, the Commission began working on a combined registration system. It knew that the technology wasn't there yet, but knew it had to be part of the program because the earlier method of handing the taxpayer a stack of papers to register in all the states was not satisfactory. Even when the MTC put up a link on its website that allowed taxpayers to go directly to various state websites for registration, the process took an unacceptably long period of time. In 2001 the Commission began working on a one-stop registration system. The original model was to have several private providers accessible via the MTC website that a taxpayer could go to for centralized registration. But private providers were not interested. Then, the leadership of SSTP came to Commission and inquired how there could be a system under control of the states rather than private providers. In late January 2004, SSTP made a formal request. The Commission had money to develop a system, but would need money to operate it. After a 30 day evaluation period, the combined registration committee held meetings, and on March 2nd approved the plan. On March 3rd, the Executive Committee reviewed the plan and approved moving forward, committing funding for development contingent on funding being provided for operating the system. No one raised any issue about MTC's operating the system. Staff proceeded forward spending money to develop the system. In August, COST raised issues for the first time about the MTC's operating the system.

Public Notice and Agenda
MTC Executive Committee Meeting
Washington, DC—November 11-12, 2004
Page 14

Scott Peterson reported that in October, two decisions were made: the Conforming States would enter into a MOU with MTC for building the system and would set up a process for considering who will operate the system. A committee made up of Loren Chumley, Richard Finan, Angela Monson, Jerry Johnson, Larry Wilke and Jane Page, Steve Kranz and Scott Peterson will evaluate what should happen. They have discussed the needs of all sectors. The first goal is to get the MOU drafted to get the system ready. Operational decisions will come afterwards.

Dan Bucks reported that staff is not ready yet to present a draft of an MOU to the Executive Committee for review. Under discussion are several paths for moving from a system that the MTC would operate to operation by another party. He outlined the two different services, the long-path, one-stop service for multiple taxes, and the short-path limited service for registering remote sellers who have nexus in only one or two states but want to register everywhere under the streamlined system. He pointed out that it would be very useful for these systems to work together since the SSTP agreement requires that one who registers must register in all locations with nexus. There are tremendous economies of scale to operate both together. The original timetable was to have the SSTP system up by January 1, 2005. Staff is now moving forward on the long-path system to be ready in February 2005 for testing in a few states. In March and April staff will be testing the short-path streamlined system, with plans that it be operational in the spring. Version 1.5 of the long-path system will be ready later in the spring and will include withholding taxes. All the systems should be ready to go in summer of 2005.

Will Rice noted that the simplification of the SSTP would be available to all taxpayers, not just remote sellers. Shouldn't the registration system also be available to all sellers, not just remote sellers? Dan Bucks responded that the system that the project requested was just for remote sellers. The short path system will be useful only to a limited number of sellers. Scott Peterson noted that big retailers wanted SSTP to have a system that everyone could use, but as it evolved, the agreement called for a system for taxpayers who have nexus in only one state, but did business everywhere. They didn't need much information for all these other states. Bruce Johnson made a technical distinction. The Agreement requires a one-stop streamlined sales tax registration for anyone who wants to use it. It will be sufficient for sales tax in all states even for big ones, but only for sales tax. For all other taxes (such as withholding) they will have to go elsewhere. So practically it is not useful for the big retailers who will need to register for other taxes in most states. But the Agreement imposes no additional sales tax registration requirements. Steve Kranz noted that the Agreement requires a system that allows all sellers to register for all states, not just remote sellers. Dan Bucks agreed, but noted that the system that the SSTP developed had only 9 or 10 elements. That is sufficient for registration for all sellers, but it is not terribly useful for any taxpayer that needs to register for more than just sales and use tax. He handed out the presentation on the SSTP system, referencing page 5 that describes the screens that the Project designed. Then he referenced the screens that the Commission has designed for the long-path registration, including additional information required by specific states. Will Rice hoped that we would not lose sight of the 1990 goal of having a simplified system that works for most businesses for a one stop system to register for all their tax obligations for all states. Bruce Johnson

Public Notice and Agenda
MTC Executive Committee Meeting
Washington, DC—November 11-12, 2004
Page 15

noted that the market would decide, those businesses that wanted to register for just sales and use tax could use the simplified system, but the others would probably want to register by the long path.

Scott Peterson reiterated that he needs a contract to develop the system. The first deadline is February 15th. He recognizes that what the SSTP has asked for is very limited. The broader project is a worthy goal. Whether that is possible is not entirely clear. But regardless, he wants to get what the SSTP needs taken care of first. Dan Bucks suggested an early December Executive Committee teleconference to approve the MOU. Bruce Johnson noted that he has a fiduciary duty to both organizations. His expectation, however, is that the MTC will proceed to negotiate an MOU with the Conforming States for the development, and then a competitive bidding process for the operation of that system will proceed. Notwithstanding that process, MTC will likely continue to develop the long path process for those who want to do more than just register for sales and use taxes.

Dan Bucks noted that the MTC has long maintained a data base for voluntary disclosure registration entirely separated from our audit process. Information on who has come forward is not disclosed to states that do not settle. Nor is it disclosed internally to the audit program. The Commission has successfully maintained that firewall for the 15 years that the Voluntary Disclosure program has existed. Its design of the long-path system will keep the registration data entirely separate, with security and firewall, from the rest of MTC operations. The data itself is owned by the states, not the Commission, and is under the control of Streamlined. The Commission would not be able to do anything with the data on its own.

Steve Kranz agreed that the MTC “practice” has been to keep this information separate and that the firewall has worked. He disagreed that only COST has objected to MTC operation of the system; many businesses are concerned that the “practice” would not remain in place. It is a perception issue rather than a substantive issue. The concern is that if the MTC operates the system, businesses may not volunteer.

Joan Wagnon asked about the action the Committee is to take today. The required action will be to ratify an MOU when it is finalized, but that will not be today. She agreed with the Chair that the Commission should watch out for its own interests, propose an MOU that protects those interests and continue to develop a long-path system which will be useful to all.

Dan Bucks noted that whatever operating rules affect Streamlined, the MTC would not have any authority to change those rules. With regard to Voluntary Disclosure, it is not just “practice” but is integral to the operation of the system and cannot practicably be changed and have the program work. For SSTP, the MTC would be legally bound by the Governing Board rules. This would be set out in the MOU.

Elizabeth Harchenko expressed concern as a Commission member from a non-sales tax state that the Commission develop a product that is useful for non-sales tax states. The

Public Notice and Agenda
MTC Executive Committee Meeting
Washington, DC—November 11-12, 2004
Page 16

Chair noted that we are developing both systems. Dan Bucks agreed that they could operate together. The real question, the Chair noted, is whether they are severable so that someone else can operate the short path system. The MTC long-path system will be available to everyone, and perhaps the marketplace will eventually drive more and more taxpayers to choose to use the long path system rather than a separately operated short path system. Developing the short path is consistent with what we have been doing with our long path. Dan Bucks expressed the hope that the bidding process would be fair and open. There will need to be a consultation on a bid the Commission may make in the future.

XII. Legal Developments Affecting the States

A. Staff Report

Frank Katz, MTC General Counsel, gave the Legal Division 3rd Quarter Report. He drew the Committee's attention to the written report included in the members' binders. The Commission filed an amicus brief in the *Lanco* case out of New Jersey to advance economic nexus principles for income tax. *Lanco* is an intangible holding company case. Our brief was focused on the argument that *Quill* has not been applied to income tax, nor should it be because it does not impose an undue burden comparable to what had been the case with sales and use taxes. Consequently, no physical presence standard has been established for income tax. Further, by maintaining the good will associated with the trademarks, the operating company is, in the direct words of *Tyler Pipe*, "performing services [for the trademark holding company] to help it maintain its market." Elizabeth Harchenko asked if New Jersey consulted with MTC legal staff about the position they took. Mr. Katz indicated they did not contact us; however, he believes they did make the factual record necessary to support the "maintenance of the market" argument.

Staff also provided assistance to New Mexico in preparing for its argument in the *Kmart Properties Inc.* case before the New Mexico Supreme Court.

B. Amicus Brief Requests

1. Request from Kansas for brief in support of petition for certiorari with the U.S. Supreme Court in *Richards v. Prairie Band Potawatomi Nation*.
2. Request from Idaho for brief in support of petition for certiorari with the U.S. Supreme Court in *Hammond v. Coeur d'Alene*.

Frank Katz explained that the MTC has received two requests for Amicus Briefs on Petitions for Certiorari to the U.S. Supreme Court in cases dealing with Native American issues. The first one is from Kansas, on its *Prairie Band Potawatomi Nation* case. The second one is from Idaho on its *Coeur d'Alene* case.

Mr. Katz first summarized the *Prairie Band Potawatomi* case. He noted that there is a written memorandum on the case in the Committee's binder. A memorandum on the case from the Kansas Department of Revenue to the National Association of Attorneys

Public Notice and Agenda
MTC Executive Committee Meeting
Washington, DC—November 11-12, 2004
Page 17

General is attached to the memorandum from Mr. Katz. At issue is the State's ability to collect fuel tax imposed on a non-tribal distributor for gasoline that is received off-reservation but ultimately sold to a tribal retailer located on-reservation, and close to a tribal casino, for ultimate sale to tribal and non-tribal customers. The 10th Circuit Court of Appeals held that although the tax was imposed off-reservation on non-tribal members, it was preempted because the State's interest in imposing the tax is outweighed by tribal and federal interests against the tax. The Circuit also held that the existence of the tribe's gaming enterprise in close proximity to the tribe's gas station imbued the fuel sales with value generated on the reservation. The U.S. Supreme Court petition will raise three issues: 1) Should a balancing test be applied at all where State tax is imposed off reservation on non-tribal members merely because the transaction or product being taxed is later marketed to a tribal retailer for subsequent on-reservation resale to tribal and non-tribal members? 2) If a balancing test should apply, should the Court abandon the *White Mountain Apache Tribe* interest-balancing test in favor of the test used for federal contractors? 3) If the *White Mountain Apache Tribe* balancing test should apply, was it properly applied?

Mr. Katz next summarized the *Hammond v. Coeur d'Alene* case. He explained that this case also presents a fuel tax and Native American issue. Here, while the Idaho statute explicitly states that the fuel tax is imposed on the distributor, the 9th Circuit found it to be, in fact, imposed on the retailer; and since the retailer in this case was a tribal station, the state tax was barred absent specific congressional authorization. The Ninth Circuit rejected the state's argument that the Hayden-Cartwright Act provides that authorization for State taxation.

The Chair asked what the provisions were in the Idaho statute that the Court had relied on to determine the tax was on the retailer. Ted Spangler answered that it was the provisions for refund for off-road fuel use.

Will Rice asked about the procedure for reviewing a draft amicus brief. Mr. Katz explained that if the Executive Committee approves the filing of a brief a draft could be circulated to whomever would like to review prior to filing. His intent is to focus the brief primarily on the off-reservation aspect of the case which he believes is the strongest point. Elizabeth Harchenko asked if the issue for these briefs would focus on the rationale for the court to take the case more than on the merits of the case. Mr. Katz agreed and explained that the 10th Circuit case is contrary to established Supreme Court jurisprudence on the issues. The holding would open up virtually any transaction in a state where there could be a subsequent sale to a tribal business to an attack on the imposition of tax on the first transaction. On the Idaho case, the Hayden-Cartwright Act issue has been up in several states and its time the Supreme Court gave the issue a look. Ted Spangler noted the states are not all consistent on how the Act should be interpreted. Mr. Katz stated that in both cases we would be arguing that there is a body of law that needs to be clarified, and the fact that both Native American/State Taxation cases are coming up at once will probably raise the profile of both issues a bit. There is a strategy for presenting these in a coordinated way to the Court, rather than hammering independently on particular points.

Ms. Harchenko asked representatives from Kansas and Idaho if they will also be seeking support through the National Association of Attorneys General and the answer from both was “yes.” Ms. Harchenko expressed concern that in Oregon there is a thoughtful, inclusive process followed by the AG to determine whether it will sign on to a NAAG brief. She does not want to get ahead of that process in approving this brief. Mr. Katz explained that the MTC brief is filed on behalf of the MTC as an organization and not filed on behalf of any particular member State or States. There will be disclaimer language to that effect in the brief. He read an example of the language from the MTC’s recent AT&T brief. Mr. Bucks explains that that language allows the MTC to file and for the member States to also sign on other briefs. The Chair suggested that if the Committee decides to approve the amicus for this stage of the proceeding, we should also do as much research as we can to make sure we can make a reasoned decision on what to do if we get a request to file on the merits. Joan Wagnon stated that her staff tells her there is only about a 2% chance the Supreme Court would take the case, but that the chance increase to about 40% with an MTC amicus brief.

Kansas moved to approve MTC filing of an Amicus brief in support of the Kansas petition for certiorari with the U.S. Supreme Court. Oregon seconded. The motion passed.

Idaho moved for approval of MTC filing an Amicus brief in support of the Idaho petition for certiorari with the U.S. Supreme Court. Kansas seconded. Washington abstained. The motion passed.

3. Request from California FTB for brief in the California Supreme Court in the *General Motors Corporation v. Franchise Tax Board* case

Mr. Katz informed the Committee that the California Franchise Tax Board has requested the MTC file an amicus brief in the California Supreme Court in support of the State on the merits of the *General Motors, Inc.* case. There are two issues in the case. The first issue is whether the return of principal that occurs when investments of cash in short-term securities are held to maturity should be included as “gross receipts” for purposes of determining the sales factor in the UDITPA three-factor apportionment formula. The MTC has adopted a regulation that defines gross receipts and explicitly excludes the return of principal such as that at issue in this case. The MTC could contribute to this issue by explaining the policy rationale for that regulation. The second issue involves the question of whether tax credits can be claimed by a unitary business as a whole, or whether they may be claimed only by the individual taxpayer members of that unitary business. The MTC’s proposed model statute on combined reporting specifies that as a general rule credits may only be claimed by the individual taxpayer members of the unitary business. The MTC could contribute to this issue by explaining the policy rationale for its position and by cataloguing the practice of the different states to give the Court a multistate perspective.

Public Notice and Agenda
MTC Executive Committee Meeting
Washington, DC—November 11-12, 2004
Page 19

Oregon moved to approve the MTC filing an amicus brief on the merits in the General Motors, Inc. case in the California Supreme Court. Michigan seconded. Steve Krantz noted that COST has filed a brief on the second issue. The motion passed.

C. Montana request to have Dan testify in case.

Montana has asked Dan Bucks to testify in the *Elliot* case regarding confidentiality of corporate taxpayer information. The suit is based on the Montana constitution's right to know and right to privacy provisions that reference an *individual's* right of privacy. Separate constitutional provisions on trade secrets may figure in. Mr. Bucks would not testify about the general policy, but rather on what the effect would be on Montana's ability to get tax information if the corporate returns would be public. The bottom line is that the flow of information from the IRS and the other states would stop. Also, Montana's ability to participate in the joint audit program would be compromised.

XIII. Federal Issues Affecting the States

A. Legislation Directly Affecting State Taxes:

1. Technology and Telecommunications Issues: Internet Access; Voice over Internet Protocol, and the Telecommunications Act of 1996 (anticipated rewrite in 109th Congress).

The Internet bill was not finalized before recess, but is expect to be taken up in the lame-duck session. The FCC recently addressed VoIP but allegedly in a way that will not affect state taxes.

2. Business Activity Taxes.

HR 3220 could pass a subcommittee in the lame-duck session.

3. Streamlined Sales Tax Legislation.

Dan Bucks reported that there have been no new discussions on federal legislation since July at NCSL. No effort has been made to reconvene those discussions. The MTC had discussed replacing the Court of Federal Claims with a panel of state judges. Jim Peters showed some interest in such a process.

4. Telecommuter Tax Fairness Act of 2004.

Dan Bucks reported on a letter received from Professor Zelinsky at Cardozo Law School requesting our support on this bill. He intends to respond that the MTC was established to promote voluntary uniformity among the states, not federal preemption. But the Commission could consider providing a forum for discussion of such uniformity, and what the standards should be. The actual legislation invokes a physical presence standard

Public Notice and Agenda
MTC Executive Committee Meeting
Washington, DC—November 11-12, 2004
Page 20

that may not be acceptable to the MTC. Mr. Bucks suggested that we agree to meet with Zelinsky and offer our consultative process.

Joe Thomas gave background on Zelinsky's case. CT would impose income tax on a resident that fully telecommuted, and so would NY. Zelinsky's case was not true telecommuting, however, as he did most of his work at the law school in NY. CT would not have taxed him on the income he earned from his NY employer.

Will Rice pointed out that this may not be a high priority in which to engage our limited time. Dan Bucks notes, however, that the specter of federal preemption in the bill may raise the importance of the issue.

The Committee suggested a letter response to Zelinsky and that staff monitor the legislation and not spend much time on the issue.

B. Closed Informational Session on Possible Federal Tax Restructuring.

XIV. Membership Policies

A. Current Membership Categories and Potential Modifications

Dan Bucks noted that there seems to be some interest among certain states in supporting some of our general tax administrative work, but they don't quite fit into our current membership structure. Staff is looking at options, but doesn't have any suggestions at this time. The Commission is in discussion with one state with regards to modifying its membership category.

B. Issue Pending with Budget Subcommittee Concerning Current Fee Categories and Allocations

Should the Commission be looking at incorporating the nexus fee into the general fee? The budget subcommittee has prepared some data. Such a change would be dramatic in certain cases, making it seem infeasible at this time. So the matter is dormant.

XV. Future Meeting Plans

Elizabeth Harchenko requested that since we have done a lot of assignments of tasks, in advance of full set of minutes it would be helpful to extract a TO DO list.

A day and one half is currently scheduled for the Executive Committee meeting in January in San Diego. That does not seem to be sufficient time to deal with all issues and strategic planning. The Committee opted to go a full day on Friday.

Public Notice and Agenda
MTC Executive Committee Meeting
Washington, DC—November 11-12, 2004
Page 21

For the April 28-29th meeting in DC, the Committee will probably need an additional day to deal with pending federal matters, perhaps done in conjunction with the FTA.

The December teleconference was scheduled for Thursday, December 9th to discuss the MOU with the Conforming States. That meeting will, as usual, be open to the public who come to DC office. But the NCSL is meeting in Savannah that week and this would make Steve Kranz's participation problematic. Staff was directed to work this out.

XVI. Adjournment